Written Testimony

of

**John Frenz, CEO,
Frenz & Schmidtknecht, Inc.,
operating Montana Mike's Steakhouse**

for the hearing

"Expiring Tax Incentives: Examining Their Importance for Small Businesses on the Road to an Economic Recovery"

before the

**U.S. House of Representatives
Committee on Small Business**

on behalf of the

National Restaurant Association

Wednesday, September 30, 2009

1200 SEVENTEENTH STREET, NW • WASHINGTON, DC 20036-3097

TEL: 202.331.5900 • FAX: 202.331.2429 • WWW.RESTAURANT.ORG

Chairwoman Velazquez, Ranking Member Graves, members of the House Committee on Small Business; thank you for the opportunity to testify before you today on behalf of the National Restaurant Association. My name is John Frenz, Chief Executive Officer of Frenz & Schmidtknecht, Inc., of Vincennes, Indiana. My business partner of more than 28 years, Greg Schmidtknecht, and I operate two Montana Mike's Steakhouse restaurants – casual steakhouse themed concepts located in Vincennes, IN and Danville, IL. I'm here today to ask Congress and this Committee to extend certain expiring tax provisions before the end of the year, such as the 15-year depreciation schedules for leasehold improvements, restaurant improvements and new construction and retail improvements, as well as the charitable deduction for the donation of food inventory. I also ask Congress to expand and extend beyond 2009 the 5 year net operating loss carryback provision that was included in the American Recovery and Reinvestment Act. Finally, I ask that Congress increase the business meal deduction from its current level of 50 percent to 80 percent to provide additional stimulus to the economy.

I began my restaurant career as a busboy at the Courtyard Cafeteria in downtown Minneapolis, Minnesota back in 1972. After graduating from the University of St. Thomas in Saint Paul, MN in 1977, I started as a management trainee in Marshfield, WI for Sirloin Stockade, a family steakhouse chain. In 1980, Sirloin Stockade was pulling back on rapid expansion and was selling some of their company owned restaurants. My business partner and I took advantage of this opportunity and bought our first Sirloin Stockade in January 1981. We further expanded and in 1984, joined five other franchisee groups to purchase the whole Sirloin Stockade franchise group. We helped reorganize the company and two concepts were added, one being the Montana Mike's concept. We converted our Sirloin Stockades into Montana Mike's concepts in 2000 and the franchisee group was subsequently bought out in 2004. Both our locations continue to be extremely successful operations.

I have been active in the Indiana Restaurant Association since 1982, serving as President and Chairman from 1997 until 1999. Outside the restaurant industry, I served eight years as State Representative from District 64, from 1996 through 2004, working for the citizens and small businesses of Vincennes, Princeton and Petersburg areas of Indiana. There I worked through a law change and a constitutional amendment to end the inventory tax in Indiana, among other issues that adversely impacted the restaurant and hospitality industry. Besides operating our restaurants, I currently serve as President of the Vincennes/Knox County Convention and Visitors Bureau. Tourism is a prime asset of our counties and we are constantly working to improve the awareness of the numerous tourist sites in our area.

I am proud to be a part of the restaurant industry – an industry that plays such a significant role in this nation's economy. There are 945,000 restaurant and foodservice outlets in this country. Seven out of ten restaurants are single-unit operators which means the restaurant industry is an industry of small businesses. Most eating and drinking places – three-quarters of the industry – employ 50 or fewer employees. Restaurants also serve as the conference rooms for many of the self-employed and other small businesses.

This year the restaurant industry is estimated to generate $558 billion in sales, with an overall economic impact of $1.3 trillion. Every dollar spent dining out generates $2.34 in business for other industries. The restaurant industry is one of the nation's largest private employers, employing more than 13 million people, representing more than 9 percent of the job-base. We are truly the cornerstone of this nation's economy.

Extend Leasehold Improvements, Restaurant Improvements and New Construction, Retail Improvements 15-year Depreciation Schedule

The fifteen-year depreciation schedule for leasehold improvements, restaurant improvements and new construction, and retail improvements must be extended before the end of 2009. The fifteen-year depreciation schedule has made significant capital available for restaurant owners to make capital expenditures with the tax savings. Those capital expenditures translate into jobs in the rest of the economy. In addition, a faster, more accurate depreciation schedule has a direct impact on a restaurant's bottom line. By shortening the depreciation schedule, Congress gives operators cash flow to reinvest in their businesses, allowing them to grow restaurant jobs and contribute to the community. In an industry with median profit margins of 3 to 5 percent, every penny counts.

Even during difficult economic times, restaurateurs are planning capital expenditures to improve or expand their businesses. According to the National Restaurant Association July 2009 Tracking Survey, 42 percent of restaurant operators plan to make a capital expenditure for equipment, expansion or remodeling in the next six months. The ability to plan for these expenditures and know what the tax treatment will be in subsequent years, particularly during these difficult times, is important to those who are making those decisions right now.

Moreover, this provision is an important driver of economic stimulus. Extending the 15 year depreciation schedule for leasehold improvements, restaurant improvements and new construction and retail improvements beyond 2009 will fuel economic activity and create jobs. When restaurants invest in construction and renovations, the impact spreads through the economy. Before the economic downturn, the restaurant industry spent more than $10 billion in 2007 on construction of restaurant buildings. According to the Bureau of Economic Analysis, every dollar spent in the construction industry generates an additional $2.39 in spending in the rest of the economy and every $1 million spent in the construction industry creates more than 28 jobs in the overall economy. That means that restaurant industry construction spending created 280,000 jobs in the overall economy in 2007.

Restaurant Spending on Construction

Year	Billions ($)	Jobs Created In Overall Economy
2004	5.2	145,600
2005	7.4	207,200
2006	6.6	184,800
2007	10.4	280,000

Source: U.S. Census Bureau and National Restaurant Association

In fact, Congress has frequently enacted shorter depreciation schedules to stimulate the economy and create jobs. As far back as the 107th Congress, shorter depreciation schedules for different pieces of the 15 year leasehold improvements, restaurant improvements and new construction, and retail improvement depreciation provision have been included in various economic stimulus bills.

It is also important to note that fifteen years, rather than 39 years, is a much more accurate timeframe for depreciation for restaurant buildings. With 133 million Americans patronizing restaurants each day, restaurant building structures experience a daily human assault unlike that borne by any other type of retail building. Restaurateurs must constantly make changes to keep up with the structural and cosmetic wear and tear caused by customers and employees. The heavy use accelerates deterioration of a restaurant building's entrance, lobbies, flooring, restrooms and interior walls. National Restaurant Association research shows that most restaurants remodel and update their building structures every six to eight years.

Extend the Deduction for Charitable Donation of Food Inventory for Small Businesses

The statistics are astounding. Each day, 35 million Americans are at risk of hunger. At the same time, billions of pounds of food are wasted each year. America's restaurants give back to their communities in major ways – the most significant of which is through food donation. According to National Restaurant Association research, 73 percent of restaurants donate food to individuals or charities.

The deduction for charitable donation of food inventory is a critical tool in alleviating hunger and Congress cannot delay its extension any longer. Without the provision, taxpayers get the same tax treatment for throwing out surplus food as they do for giving it to charity. The enhanced deduction encourages donating the food to charity instead, by helping to offset the costs associated with storing and transporting the extra food.

For this tax extender to be effective in encouraging more small businesses, including restaurants, to donate food that would otherwise go to waste, it must be extended before the end of 2009. If Congress were to wait to extend this provision until 2010, it would be ineffective for the period that it was not in place. The perishable nature of the donated product requires this provision to be in place before such food is produced and goes bad.

Moreover, Congress should make this tax extender permanent for all small businesses as the tax code currently does for C corporations – and has for decades. The Good Samaritan Hunger Relief Tax Incentive Extension Act (H.R. 3227) is sponsored by Congressmen Levin (D-MI) and Davis (R-KY) in the House and would expand and make permanent this tax extender provision for small businesses, farmers and ranchers to donate food inventory to charity. The Senate companion bill (S. 1212) is sponsored by Senators Lugar (R-IN), Lincoln (D-AR), and Leahy (D-VT).

H.R. 3227 and S. 1212 would permanently allow all qualified business taxpayers (not just C corporations) to take a special deduction for contributions of food inventory. In addition, because the need is so great in the current economic environment, the legislation would temporarily allow taxpayers to deduct the full fair market value of food inventory donations.

The National Restaurant Association strongly encourages its members to donate more food, and we recently partnered with Food Donation Connection (FDC) to do just that. Founded by a former restaurant executive, FDC serves as the liaison between the restaurants interested in donating food and the social service agencies adept at getting that food to people in need. FDC helps restaurants develop and implement programs designed to provide an alternative to discarding surplus food, while capitalizing on the economic benefits of those donations through the tax savings. Since 1992, FDC has helped facilitate the donation of over 140 million pounds of food to non-profit, hunger-relief agencies.

I ask members of this Committee and all members of Congress to extend the deduction for charitable donation of food inventory before the end of 2009 and to cosponsor H.R. 3227 and S. 1212, the Good Samaritan Hunger Relief Tax Incentive Extension Act.

Extend the expansion of Net Operating Loss Carryback

Many in the restaurant industry continue to struggle in these difficult economic times. While the country may officially be coming out of a recession, consumer spending remains low and, as a result, customer traffic in restaurants is significantly decreased. More restaurants are likely to be facing losses than ever before; moreover, the magnitude of the operating losses is likely to be larger. At this time, America's restaurants need the benefit of an extension of the American Recovery and Reinvestment Act's expanded net operating loss (NOL) provision from 2 years to 5 years. An expansion of the provision to include all businesses should also be considered, as is addressed in H.R. 2452 introduced by Congressmen Richard Neal (D-MA) and Patrick Tiberi (R-OH) and S. 823 introduced by Senator Olympia Snowe (R-ME) and Senate Finance Committee Chairman Max Baucus (D-MT).

NOL carrybacks allow small businesses, like restaurants, to smooth out changes in income over the business cycle by allowing losses to be offset against past profits. This provides a critical and immediate cash infusion to businesses when they incur losses – the time when businesses need additional funds the most.

Because the NOL carryback measure is one of the few effective tax policies available to businesses in a loss position, it is highly stimulative. The cash infusion provided by an NOL carryback gives small businesses the resources necessary to make investments, hire and retain workers, and, in certain cases, keep their doors open.

When Congress has enacted NOL carryback relief in the past, it has proven to be an effective economic stimulus measure. In the Jobs Creation and Worker Assistance Act of 2002, Congress provided a five-year NOL carryback for 2001 and 2002. In support of the legislation, Congress explained, "The current uncertain economic conditions have resulted in many taxpayers incurring unexpected financial losses…The provision will free up funds that can be used for capital investment or other expenses that will provide stimulus to the economy." And, in fact, the measure proved successful in providing necessary relief to businesses across all industries.

America is coming out of an economic recession that may be the worst since the Great Depression. Given the unique ability of NOL relief to provide assistance where it is needed most, the extension and expansion of the NOL carryback period from two to five years should be extended beyond 2009.

Increase the Business Meal Deduction to Stimulate the Economy

The National Restaurant Association strongly urges Congress to provide additional economic relief for this nation's economy and to implement policies that will boost consumer spending. Increasing the business meal and entertainment deduction from 50 percent to 80 percent is a key provision for small businesses. For many small companies the ability to conduct business over a meal is their only means of advertising and marketing their business.

While officially the recession may be ending, the restaurant industry is still reeling from the effects of decreased consumer spending and increased unemployment. Increasing the business meal deduction would encourage consumers to eat out and also benefit small businesses. America's restaurants are small business' conference rooms and the restaurant table is where much business is conducted. Increasing the deduction is a benefit not only to restaurateurs and their employees, but their guests – the small business owner or the self-employed.

The Small Business Committee has been a long time supporter of increasing the business meal and entertainment deduction as a means of providing tax relief for the nation's small businesses. Last Congress, this Committee included a provision to increase the deduction from 50 percent to 80 percent in the *Small Business Tax Modernization and Stimulus Act of 2008.* While this legislation was not enacted into law, the National Restaurant Association applauds the Committee's continued leadership to restore this valuable deduction.

Representative Neil Abercrombie (Hawaii – 1st) has re-introduced H.R. 3333, a bill that would increase the business meal and entertainment deduction to 80 percent for all business meal users. An increase in the business meal deduction to 80 percent would increase business meal sales by $6 billion and create an $18 billion increase in the overall economy, according to National Restaurant Association research. The impact of the restaurant industry on the nation's economy is considerable and felt in every state (See Figure 1). We service 133 million guests every day. Every dollar spent dining out generates $2.34 in business to other industries, totaling $1.3 trillion in overall economic impact.

We appreciate the Committee's continued support for the business meal and entertainment deduction and look forward to our continued work together to enact this legislation.

Conclusion

I greatly appreciate this opportunity to testify on behalf of the restaurant industry before you today. I strongly urge Congress to extend these important tax provisions before the end of the year.

The restaurant industry needs certainty when it comes to the 15 year depreciation schedule for leasehold improvements, restaurant improvements and new construction and retail improvements as capital expenditures are being considered and planned.

Small businesses, including restaurants, need at minimum the extension of the deduction for charitable donation of food inventory before the end of the year.

Congress must extend some provisions of the America Recovery and Reinvestment Act such as the expanded net operating loss carryback provision as restaurants and other businesses continue to have a difficult time in this economy.

Additionally, Congress should consider additional items that will help boost the economy and create jobs like an increase in the business meal deduction to 80 percent.

Thank you for considering the restaurant industry's perspective and ideas regarding expiring tax provisions and stimulus items.

Figure 1.

Estimated Impact of Increasing Business Meal Deductibility from 50% to 80%

State	Increase in Business Meal Spending 50% to 80% Deductibility (in millions)	Total Economic Impact In the State (in millions)	Total Employment Impact In the State (number of jobs created)
Alabama	$77	$155	2,464
Alaska	$17	$29	401
Arizona	$118	$235	3,125
Arkansas	$43	$87	1,451
California	$767	$1,797	20,868
Colorado	$114	$264	3,328
Connecticut	$71	$133	1,624
Delaware	$19	$35	402
District of Columbia	$31	$43	254
Florida	$368	$745	9,746
Georgia	$193	$446	5,642
Hawaii	$44	$86	1,154
Idaho	$24	$47	799
Illinois	$256	$610	7,207
Indiana	$117	$241	3,712
Iowa	$47	$95	1,544
Kansas	$46	$92	1,314
Kentucky	$78	$158	2,266
Louisiana	$81	$158	2,374
Maine	$24	$46	709
Maryland	$113	$235	2,750
Massachusetts	$161	$324	3,884
Michigan	$171	$341	5,272
Minnesota	$105	$240	3,270
Mississippi	$41	$78	1,340
Missouri	$115	$256	3,512
Montana	$20	$39	682
Nebraska	$31	$64	1,048
Nevada	$71	$127	1,703
New Hampshire	$29	$53	653
New Jersey	$170	$367	4,139
New Mexico	$37	$66	1,079
New York	$379	$751	8,855
North Carolina	$176	$371	5,435
North Dakota	$11	$20	333
Ohio	$217	$466	6,978
Oklahoma	$60	$127	2,016
Oregon	$82	$169	2,274
Pennsylvania	$212	$478	6,311
Rhode Island	$24	$45	598
South Carolina	$87	$179	2,689
South Dakota	$14	$27	458
Tennessee	$121	$272	3,531
Texas	$477	$1,164	14,109
Utah	$41	$92	1,375
Vermont	$11	$19	288
Virginia	$157	$331	4,155
Washington	$129	$279	3,419
West Virginia	$28	$47	830
Wisconsin	$100	$210	3,399
Wyoming	$10	$16	293

Source: National Restaurant Association estimates, 2009